

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



September 27, 2005

Agenda ID # 4968
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 05-03-005

This is the draft decision of Administrative Law Judge (ALJ) Maribeth Bushey. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov/PUBLISHED/RULES PRAC PROC/44887.htm>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN by LTC
Angela K. Minkin, Chief
Administrative Law Judge

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Attachment

Decision **DRAFT DECISION OF ALJ BUSHEY** (Mailed 9/27/2005)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of SBC California
(U 1001 C) for a Surcharge and a Balancing
Account to Recover Undergrounding Costs in the
City of San Diego.

Application 05-03-005
(Filed March 3, 2005)

INTERIM OPINION DENYING MOTIONS TO DISMISS**I. Summary**

In this decision, we deny motions to dismiss from the Office of Ratepayer Advocates (ORA) and CALTEL¹. Based on the arguments presented, we also provide further guidance to the parties for the next phase of this proceeding.

II. Background

In January 2001, the City of San Diego (City) adopted its Underground Utilities Procedural Ordinance to provide for the expedited undergrounding of overhead utility wires within the city limits. The City's goal is to underground all currently overhead utility lines in 20 years. To accomplish this goal, the City must quadruple the current rate at which utility lines are undergrounded.

This Commission has adopted comprehensive, statewide rules that govern when and where a utility may remove overhead lines and replace them with

¹ For purposes of today's decision, "CALTEL" refers to the following parties acting together: XO Communications Services, Inc., MPower Communications Services, Inc., Telscape Communications, Inc., and the California Association of Competitive Telecommunications Companies.

underground service, and whether such costs will be recovered through rates. These rules are set forth in Tariff Rule 32 for SBC California (SBC) and Tariff Rule 20 for San Diego Gas and Electric Company (SDG&E). To accommodate the City's ordinance, SDG&E sought Commission authorization to deviate from Tariff Rule 20. In Resolution E-3788, the Commission granted both SDG&E and SBC permission to deviate from their respective tariffs and comply with the City's ordinance.

To finance SDG&E's portion of the undergrounding project, the City and SDG&E entered into an agreement whereby the franchise fee SDG&E pays to the City would increase from 1.9% of gross revenues to 5.78%. Ninety percent of the increased funds would be used by the City to pay for the undergrounding. The Commission also authorized SDG&E to increase the City's franchise fee surcharge to all City customers to reflect the increased fee, and directed SBC to file an application to seek permission to recover its increased undergrounding costs from City customers.

On March 3, 2005, SBC filed this application to approve a surcharge and balancing account to track and recover its costs for the City undergrounding project.

On April 7, 2005, the Utility Consumers' Action Network (UCAN) protested the application, arguing that undergrounding costs are before the Commission in the undergrounding rulemaking (Rulemaking 00-01-005). UCAN also found SBC's cost estimates to be "shockingly high" and suggested that the proposed cost recovery might violate the New Regulatory Framework (NRF).

On May 2, 2005, XO Communications, Inc., MPower Communications Corp., and the California Association of Competitive Telephone Companies submitted their late-filed protest, along with a motion seeking leave to file it, and

argued that SBC is already being compensated for undergrounding costs pursuant to rates set under the NRF.

On April 18, 2005, the ORA filed a motion requesting permission to late-file its protest to this application, which was granted on May 3, 2005. ORA also challenged the requested relief as violating NRF principles.

On April 29, 2005, Telscape Communications, Inc. (Telscape) filed a motion seeking permission to late-file its protest to the application, with the protest attached. In its protest, Telescape stated that SBC-California proposes to place a surcharge on the fees Telscape pays to lease unbundled basic loops from SBC. Telscape contended that such a surcharge violates federal law, and that undergrounding costs must be allocated between regulated and unregulated services. ORA and a coalition of the competitive carriers (CALTEL, see footnote 1) filed motions to dismiss, and SBC and the City responded. CALTEL also filed a reply.

On May 24, 2005, the assigned Administrative Law Judge (ALJ) convened a prehearing conference. To resolve the threshold issues of whether the Commission was prohibited by federal law or NRF from approving the proposed surcharge, a schedule was set to consider the motions to dismiss. This decision resolves the motions to dismiss.

III. Positions of the Parties

A. ORA

In its motion, ORA concedes that the Commission has the authority to grant SBC's request for a surcharge and balancing account. ORA, however, reviews NRF history and principles, and concludes that the Commission should not do so. ORA explains that the basic premise of NRF is that utilities bear the risk of poor business decisions but also retain the benefits of efficient

management. NRF utilities, such as SBC, are not subject to traditional cost of service ratemaking but rather the Commission sets a price cap and the utility must manage its costs. At one time, a NRF utility could seek a rate change for unforeseen expenses, referred to as “exogenous costs.” The Commission, however, has suspended such cost recovery and insisted that NRF utilities bear the risk of such cost increases, just as they reap the rewards of any cost decreases or productivity improvements. ORA concludes that surcharges and balancing accounts are simply incompatible with NRF.

Turning to the specific costs SBC seeks to recover, ORA contends that undergrounding costs are ordinary, controllable business costs that are the shareholders’ responsibility under NRF. ORA points out that SBC management executed an agreement with the City whereby SBC is under no obligation to underground its lines unless the Commission grants the requested surcharge. ORA also noted that the City newspaper accused SBC of “holding the undergrounding project hostage until it gets its way.”

ORA further explains that NRF rates include an assumed level of undergrounding, and that to the extent the Commission allows SBC to recover these costs through a surcharge, SBC will be recovering the same costs twice, “double-dipping.” ORA concludes that NRF prohibits such dual cost recovery.

B. CALTEL

CALTEL states that SBC’s proposed surcharge on lines served by competitive local exchange carriers in the City violates federal law, and that changing the price these carriers pay by adding a surcharge would be procedurally unlawful. CALTEL explains that the price at which it purchases unbundled loops from SBC is set by a detailed methodology adopted by the Federal Communications Commission (FCC). That methodology, total element

long-run incremental cost, rejects actual cost of service and instead substitutes a hypothetical least-cost, most efficient network. In support, CALTEL points to 47 U.S.C. § 252(d)(1) which prohibits state commissions from setting prices for network elements by “reference to a rate-of-return or other rate-based proceeding.” In contrast to federal law, CALTEL argues, SBC seeks to recover its actual costs of making changes to the City’s network. CALTEL concludes that recovery of such costs through charges for unbundled network elements is prohibited by the FCC’s rules, and that the application should be dismissed.

CALTEL also argues that SBC’s proposed change in the price that competitive local exchange carriers would pay for network elements requires notice and an opportunity to be heard to all parties that participated in the Commission’s proceeding setting the network element prices.

CALTEL next challenges SBC’s entire proposed surcharge, not just as applied to competitive local exchange carriers, as violating both “the spirit and the text” of prior Commission decisions creating NRF. Like ORA, CALTEL argues that under NRF, SBC bears both the risk of increased costs, such as undergrounding, and the benefits of cost reductions and enhanced efficiency.

C. SBC

In opposition to the motions to dismiss, SBC argues that neither NRF nor federal law precluded the Commission from approving the requested surcharge. SBC emphasizes that the decision to underground utility lines in the City was made by the duly elected representatives of San Diego, and that this extraordinary project will result in an unprecedented plant structure, i.e., all facilities underground.

SBC concedes that NRF places the risks of business and operating decisions on SBC’s shareholders, but contends that the City’s undergrounding

program was not a decision of SBC's management. SBC required special permission from this Commission to deviate from approved tariffs and participate in the City's requested level of undergrounding. SBC concludes that its shareholders should not bear the burden of this unprecedented level of undergrounding expenditures.

SBC also argues that federal telecommunications law does not prohibit the Commission from approving the requested surcharge. SBC explains that its application "does not seek to change the UNE loop rate or otherwise modify the rates adopted in D.04-09-063. Rather, it seeks to impose a temporary surcharge on the telephone bill of San Diego customers (both retail and wholesale) in order to recover the costs of placing existing aerial loops in San Diego underground." SBC states that federal pricing rules do not prohibit recovery of all actual costs, and that the Commission relied on SBC's actual incurred costs for certain components of the network element price, such as actual vendor contracts for switching and cable price inputs.

D. City Of San Diego

The City supported SBC's request for the surcharge to the extent such costs have not been recovered or booked for recovery and are legitimate expenses, but no more. The City also contends that its undergrounding program is unique and was not contemplated by the Commission when implementing NRF regulations.

IV. Discussion

Rule 56 of the Commission's Rules of Practice and Procedure provides a party the right to file a motion to dismiss any proceeding before the Commission. Pursuant to the schedule set at the prehearing conference, CALTEL submitted its motion to dismiss the application based on federal telecommunications law and NRF. ORA's motion to dismiss is based on NRF.

To grant a Rule 56 motion to dismiss, the Commission must determine that there are no triable issues of material fact and the moving party is entitled to judgment as a matter of law. Westcom Long Distance, Inc., v. Pacific Bell, 54 CPUC 2d 244, 249 (D.94-04-082). The parties agree that there are no triable issues of material fact necessary to resolve these motions. In today's decision, we determine that ORA and CALTEL have failed to demonstrate that they are entitled to judgment as a matter of law.

A. New Regulatory Framework

When this Commission created NRF in 1989, we provided for comprehensive review and modifications on a three-year cycle (D.89-10-031, 33 CPUC 43, 236). Since that time, we have adopted various revisions to NRF (see D.02-10-020). Neither ORA nor CALTEL have provided a citation to a Commission decision addressing the issue before us now, namely, whether a surcharge to collect extraordinary undergrounding costs is consistent with NRF. Both parties presented coherent arguments that extrapolated from past indications of Commission NRF policy. The standard for granting a motion to dismiss, however, requires that the party be entitled to judgment as a matter of law. Here, the Commission has retained supervision and jurisdiction of the NRF program, and implemented regular modifications, but has not addressed the question of extraordinary undergrounding costs. Consequently, the moving parties can not demonstrate that they are entitled to judgment in their favor as a matter of law.

Our holding today is limited. In the substantive phase of this proceeding, we will carefully review SBC's proposal in light of NRF, as modified over the years, and other Commission law and policies. We have not pre-judged the outcome of this review. We may ultimately decide that SBC's proposed

surcharge is not consistent with the NRF or other Commission policies. Today's decision holds only that, as a matter of law, this Commission may consider SBC's proposal.

B. Federal Telecommunications Law

We are similarly without precedent squarely on point with regard to CALTEL's motion based on federal telecommunications law. As discussed below, however, Congress retained local authority to "manage" rights-of-way, which the City has exercised with its ordinance requiring undergrounding. SBC now proposes a Commission-approved surcharge on each telephone line in San Diego to recover the costs of complying with the ordinance in a competitively neutral manner. We are not persuaded that Congress clearly intended to preclude such a surcharge as a matter of law, and we therefore deny CALTEL's motion to dismiss the application.

CALTEL relies primarily on federal law and FCC regulations describing the methodology for setting prices for the network elements as the basis for its assertion that the Commission is precluded from adopting SBC's proposed surcharge. The pricing methodology, however, does not specifically address extraordinary undergrounding costs, either to specifically include or exclude these costs.

CALTEL argues that the proposed surcharge on unbundled loop rates is irreconcilably inconsistent with the FCC's mandatory pricing rule. CALTEL states that the FCC's pricing rule rejects actual costs in favor of a hypothetical most efficient, least cost system on which to calculate rates, and this rule preempts this Commission from adopting any other rule. Because SBC's proposed surcharge is based on actual costs, CALTEL concludes that the surcharge violates the pricing rule and entitles CALTEL to a ruling in its favor as

a matter of law. Specifically, CALTEL cites to 47 U.S.C. § 252 (d)(1)(A) of the 1996 Federal Telecommunications Act which states that the rates of network elements shall be based on cost “determined without reference to rate-of-return or other rate-based proceeding.”

CALTEL is correct that this statute limits the authority of this Commission in setting only “the just and reasonable rate for the interconnection of facilities . . . and network elements.” This Commission set those rates in D.04-09-063. At issue in this proceeding, in contrast, is a collection mechanism for extraordinary undergrounding costs imposed by the City.

In the Resolution allowing SDG&E and SBC to deviate from their tariff rules which would preclude the undergrounding pace mandated by the City, this Commission specifically declined to review or second guess the City’s decision:

Elected officials in city government, representing the citizens of the City, following public notice and hearings, decided additional revenues were needed to fund an underground conversion program beyond that funded through SDG&E’s base rates. The City has determined that the program is in the public interest and we should not second-guess that decision.

In a typical rate case, this Commission determines whether costs incurred by the utility are “just and reasonable.” Here, however, the decision to impose the costs has been made by the City, a decision we will respect. Indeed, we have accommodated the City’s decision by allowing both SDG&E and SBC to deviate from their otherwise applicable undergrounding rules which are at odds with the City’s program.

SBC has now put forward a competitively neutral mechanism² to recover its costs of complying with the City's program. Under SBC's proposal, each telephone line in the City, whether served by SBC or its competitors, will bear an equal share of the costs. CALTEL argues that federal law preempts this Commission from approving SBC's proposed surcharge to the extent it would be applied to competitive local carriers. Our review of federal law reveals no support for CALTEL's assertion that it is entitled to judgment in its favor as a matter of law.

Federal preemption of state telecommunications law must be "clear," and the state action must "flagrantly and patently" violate the Constitution:

The United States Supreme Court and the Ninth Circuit have held that federal preemption of state regulation in the area of telecommunications must be clear and occurs only in limited circumstances. . . . [S]tate action may be preempted only for conduct that is "flagrantly and patently" violative of the Constitution, i.e., preemption must be "readily apparent."

Communications Telesystems International v. CPUC, 196 F.3d 1011, 1017 (9th Cir. 1999).

Rather than "clearly" preempting state and local authority over undergrounding, Congress explicitly retained such authority. In San Diego, as in most cities, utility lines are largely placed in the public right-of-way, i.e. along or under the public streets. Local governments, here, the City of San Diego, own

² For purposes of today's decision, we accept SBC's representation that its proposed surcharge is, in fact, competitively neutral. Any allegations that it is not can be resolved in the substantive phase of this proceeding.

and manage the public rights of way. Congress specifically retained full state and local authority over rights-of-way in 47 U.S.C. § 253(c):

Nothing in this section affects the authority of State and local government to manage the public rights-of-way or to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of the public rights-of-way on a nondiscriminatory basis.

The City has decided to “manage” its rights-of-way³ such that all utility lines must be undergrounded. SBC will incur costs to comply with the City’s directive, and seeks to recover those costs from San Diego customers with a competitively neutral surcharge.

Numerous surcharges are currently placed on telecommunications service bills for a variety of different purposes. One bill from a competitive local carrier included the following:

1. California Relay Service and Commission Devices Funds (Deaf and Disabled Telecommunications Program)
2. Universal Lifeline Service
3. California High Cost Fund, A & B
4. Public Utility Commission Fee
5. California Teleconnect Fund
6. 9-1-1 Surcharge

³ Federal law imposes no legal impediment to the City of San Diego directly imposing an undergrounding fee on all telephone service providers using the San Diego rights-of-way. See TCG New York, Inc., v. White Plains, 305 F.3d 67, 77-81 (2nd Cir. 2002). If the City can directly impose the same type of fee that SBC’s proposes, then CALTEL’s quarrel with the proposal appears to be one of form rather than substance.

These surcharges are not included in revenue requirement for ratemaking purposes, but rather are treated as separate cost recovery items. The amounts collected from these surcharges fund various programs, such as low-income telephone service discounts (universal service), and discounts for schools and hospitals (Teleconnect Fund). These surcharges are not subject to the FCC's cost methodology, and remain in place. CALTEL provides no persuasive analysis demonstrating that Congress, while allowing these surcharges, "clearly" intended to preempt a San Diego surcharge for extraordinary undergrounding⁴ costs.

In sum, Congress retained local authority to "manage" rights-of-way, and consistent with this authority, the City has adopted a valid ordinance requiring the undergrounding of utility lines. With the City's support, SBC has proposed a Commission-approved surcharge on each telephone line in the City to recover the costs of complying with the ordinance in a competitively neutral manner. CALTEL has not shown that Congress clearly intended to exclude extraordinary undergrounding costs from recovery via a surcharge. Consequently, CALTEL has not demonstrated that it is entitled to judgment in its favor as a matter of law, and we must deny its motion to dismiss the application.

V. Costs to be included in the Surcharge

Although we conclude that the moving parties have not met their burden of showing that they are entitled to judgment in their favor as a matter of law,

⁴ "Ordinary" undergrounding costs, however, would appear to be included in network element revenue requirement and thus would be subject to the FCC's methodology. As discussed later in today's decision, the primary issue for next phase of this proceeding will be to determine which, if any, of SBC's undergrounding costs are extraordinary.

the parties have raised valid objections to including certain cost elements in the surcharge calculations. The assigned Commissioner and ALJ should manage this proceeding to ensure that a full factual and legal record is created for our consideration on these, and any other, issues.

As ORA and CALTEL correctly note, undergrounding costs are included in both the NRF and network element revenue requirements. SBC's tariff Rule 32 sets forth a specific program, including eligibility requirements and cost allocations, for undergrounding SBC's lines. These are ordinary and expected costs. The substantive phase of this proceeding should carefully review these costs to determine the additional increment necessary to comply with the City's ordinance.

Telscape also raised the issue of SBC providing its own unregulated services using the lines in San Diego. Telscape contended that SBC's undergrounding costs should be allocated between SBC's regulated and unregulated services, with only the regulated "extraordinary" share used to determine any surcharge for competitive local carriers. This issue should also be explored and resolved in the substantive phase of this proceeding.

SBC may also realize cost savings from having the lines underground. Any such savings should be analyzed, quantified, and used as an offset to the costs SBC proposes to pass along to San Diego residents.

Finally, we agree with the parties that on-going accounting and cost allocation oversight of this program is essential.

While detailed cost studies would be necessary to evaluate each work element proposed to be recorded in the balancing account, such studies are often controversial and can lead to a lengthy hearing process. We encourage the parties to consider informal clarification of data upon which the studies will be

based, cooperative development of the studies, and any other form of joint fact-finding that might expedite the hearing process. We also encourage the parties to consider Alternative Dispute Resolution methods as a means to resolve this application.

VI. Need for Hearings

As there are no disputed issues of material fact necessary to resolve the motions, no evidentiary hearings are necessary.

VII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Maribeth Bushey is the assigned ALJ in this proceeding.

VIII. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____.

Findings of Fact

1. ORA and CALTEL filed motions to dismiss the application.
2. There are no disputed issues of material fact related to the motions to dismiss.
3. Numerous surcharges for items not included in revenue requirement appear on competitive local carriers' telephone bills.

Conclusions of Law

1. The Commission authorized SBC to deviate from its tariff Rule 32 and to implement a higher rate of undergrounding in the City.
2. The Commission retains full jurisdiction over NRF and may make any necessary modifications.

3. As a matter of law, NRF does not preclude granting SBC's requested relief.
4. As a matter of law, this Commission may consider SBC's proposal.
5. Preemption of state telecommunications law by federal law must be "clear."
6. As set out in 47 U.S.C. §253(c) of the 1996 Federal Telecommunications Act, Congress did not intend to preempt local authorities' right to "manage" their rights of way.
7. Surcharges for various public purposes are included on competitive local carriers' bills.
8. CALTEL has not shown clear evidence that Congress intended federal telecommunications law and regulations to preclude granting SBC's requested surcharge for extraordinary undergrounding costs.
9. ORA and CALTEL have not demonstrated that they are entitled to judgment in their favor as a matter of law.
10. ORA's and CALTEL's motions to dismiss should be denied.
11. This decision should be effective immediately.

INTERIM ORDER

IT IS ORDERED that the motions to dismiss submitted by the Office of Ratepayer Advocates and, jointly by, XO Communications Services, Inc., MPower Communications Services, Inc., Telscape Communications, Inc, and the California Association of Competitive Telecommunications Companies are denied.

This order is effective today.

Dated _____, at San Francisco, California.